

Lehman Bankruptcy Court Holds Contractual Right to Triangular Setoff Unenforceable In Bankruptcy and Not Protected by Safe Harbors

October 11, 2011 | Client Update

In a recent decision issued in the Lehman Brothers Inc. SIPA proceeding in the Southern District of New York, *In re Lehman Brothers Inc.*, Case No. 08-01420 (JMP) (SIPA), slip op. (Bankr. S.D.N.Y. Oct. 4, 2011), Bankruptcy Judge James M. Peck held that a contractual right to effect a cross-affiliate setoff is unenforceable in bankruptcy. The court found that mutuality is a requirement for both common law and contractual setoff under Section 553 of the Bankruptcy Code, and that the contract did not create mutuality for purposes of Section 553. The court further held that the safe harbor provisions for swaps and other derivatives contracts in the Bankruptcy Code do not permit a party to exercise a contractual right to setoff where there is no mutuality.

While the ruling is consistent with the seminal case *Chevron Products Co. v. SemCrude, L.P.* (*In re SemCrude, L.P.*), 428 B.R. 590 (D. Del. 2010) and earlier decisions in the Lehman case that have stressed the requirement of strict “mutuality” for setoff in bankruptcy as well as a narrow reading of the safe harbors (such as *Swedbank AB v. Lehman Brothers Holdings Inc.* (*In re Lehman Brothers Holdings Inc.*), 445 B.R. 130 (S.D.N.Y. 2011)), this decision is significant in that it addresses the interplay between the safe harbors and the enforceability of cross-affiliate setoff or netting provisions.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Laureen F. Bedell

+1 212 450 4167
laureen.bedell@davispolk.com

Donald S. Bernstein

+1 212 450 4092
donald.bernstein@davispolk.com

Meyer C. Dworkin

+1 212 450 4382
meyer.dworkin@davispolk.com

Timothy Graulich

+1 212 450 4639
timothy.graulich@davispolk.com

Marshall S. Huebner

+1 212 450 4099
marshall.huebner@davispolk.com

Ben Kaminetzky

+1 212 450 4259
ben.kaminetzky@davispolk.com

Elliot Moskowitz

+1 212 450 4241
elliot.moskowitz@davispolk.com

Brian M. Resnick

+1 212 450 4213
brian.resnick@davispolk.com

Damian S. Schaible

+1 212 450 4580
damian.schaible@davispolk.com

Karen E. Wagner

+1 212 450 4404
karen.wagner@davispolk.com

Erika D. White

+1 212 450 4183
erika.white@davispolk.com

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's privacy notice for further details.

Related materials

[Read the full update](#)